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CAN EXPORT AND INVESTMENT SERVICES HELP DEVELOPING COUNTRIES ACHIEVE ECONOMIC GROWTH?

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SUMMARY

For three decades, the U.S. Agency for International Development (USAID) has worked on several fronts to stimulate outward-oriented economic growth in developing countries. Toward that end, the Agency has often relied on policy dialogue to address the antiexport bias of trade and monetary policies prevalent in many of those countries. At the same time, USAID has supported a variety of programs in export and investment services to assist these countries in increasing their exports. These services have included provision of information on foreign markets and investment climate; marketing services, such as buyer contacts; and production-related technical assistance. The Center for Development Information and Evaluation (CDIE) recently completed a worldwide assessment of USAID experience with such projects. The assessment addressed several key questions, among them: (1) Are export and investment promotion services worthwhile? (2) Do they merit continued USAID support? This *highlights* summarizes the findings and conclusions of that study.

CDIE teams reviewed experience with export and investment promotion services in 10 developing countries. They visited eight countries and completed desk studies of experience in another two. The teams interviewed more than 90 service providers in the countries visited, and carried out a survey of about 300 exporters in six of those countries. The survey, which asked exporters to rate the importance of USAID-supported institutions to their export success, aimed to establish what services exporters actually used, which ones were most important to their success, and which service providers were most effective. The study also reviewed the export performance of the 10 sample countries relative to their policy environment. Five main conclusions were reached:

1. *Sound macroeconomic policies and partial trade reform are preconditions for export success and effective use of subsidized services*. Support services can, however, contribute to export success when realistic exchange rates, macroeconomic stability, and partial trade reform devices (such as duty drawback and export processing zones [EPZs]) shield exporters from the effects of antiexport policies. Moreover, support services can be particularly effective during the early stages of an export drive.

2. *Subsidized services to exporters can have high payoffs.* Donor-supported project interventions that expand exporters’ access to services can also speed export growth. A few

successful USAID-financed projects had economic rates of return ranging from 12 to 26 percent.

3. *Private sector commitment and a strong emphasis on results are critical to effective support service programs.* The more effective export promotion programs encouraged the active involvement and financial commitment of private exporters. These programs focused on results: they filtered out firms not yet ready to export, they were structured to deliver services effectively, their staff were technically qualified, and they focused on the support services most highly valued by firms new to exporting.

4. *Incipient exporters value support services most when services lead to enduring relationships with exporters' future business partners, particularly buyers, investors, and suppliers.* At the early stages of an outward-oriented strategy, support services can forge links between new exporters and their business partners, who can best help them meet international standards for price, product, and quality. But where a dynamic, competitive service provider market already exists, assistance to export support services has added little to export growth.

5. *Most government export service providers are ineffective*. They typically focus on the wrong services, lack the trained staff to provide a quality product, and become hamstrung by bureaucratic inflexibility.

BACKGROUND

Overview

Rapid growth in exports can promote faster economic growth and reduce poverty in developing countries, as demonstrated by the success of the four "Asian tigers" (Hong Kong, Singapore, South Korea, and Taiwan). A striking feature of developing countries since the 1980s has been their growing ability to produce manufactured goods that meet world standards. How can rapid export growth best be achieved? Most observers consider trade liberalization to be fundamental to stimulating export growth, but much less consensus exists on the value of direct assistance to exporting firms in developing countries. Export promotion services that provide buyer contacts, information on overseas markets, technical assistance, and the like have become a standard government service in many developing countries. Moreover, some developing countries have sought to attract foreign investors to export sectors using a variety of investment promotion services, such as information on the investment climate, site visit support, and local partner identification. From 1990 to 1993, USAID spent about $250 million a year financing such assistance to governments and private institutions.

The assessment explored whether export and investment support services contribute to export growth. It sought to answer three key questions for USAID management: (1) What is the rationale for donor support for export promotion? (2) What support service strategies and providers are most effective? and (3) Has USAID's assistance paid off?

The study examined promotion institutions in 10 countries, which were selected to reflect a diversity of service approaches and institutional structures. The first phase focused on USAID export promotion experience in the Latin America and Caribbean region. Following a desk review of 15 projects, CDIE carried out fieldwork in Costa Rica, the Dominican Republic, Guatemala, and Chile to examine successful programs in relatively favorable policy environments. CDIE then conducted fieldwork in four Asian countries: India, Indonesia, Korea, and Thailand, where programs had been implemented in a variety of policy environments. The assessment concluded with a desk review of programs in Egypt and Morocco. Although USAID has undertaken similar programs in Africa, these were too new to form a basis for evaluation.

A key element of the study was a survey of nearly 300 exporters across six of the sample countries. The firms surveyed included those receiving subsidized services from USAID-supported institutions and those not receiving such services. The survey took 33 services provided directly to exporters and broke them down into five categories:

- Information (e.g., standardized information on foreign markets, country information on the investment climate)
- Contact-making (e.g., buyer contacts, trade fairs, joint venture support)
- Preinvestment or preexport support (e.g., feasibility studies, support for site visits)
- Technical assistance (e.g., engineering, production support), training
- Government facilitation (e.g., customs assistance, help with government approvals, regulatory guidance)

The survey was used to determine what types of services exporters actually used, which ones had the greatest impact on their export growth, and who provided these services. The assessment teams examined the performance of promotion institutions, principally USAID-assisted service providers. In addition, they conducted interviews with more than 90 service providers (both USAID-assisted and those not assisted by USAID) and others in the eight countries visited. Service providers included government trade promotion departments and investment promotion boards; private nonprofit promotion institutions, including trade associations; and retailers, importers, and foreign investors.

Export Performance and Policy

Export growth in many developing countries has been undermined by the antiexport bias of their trade policies and export services. Exchange rate policies have subsidized imports and penalized exporters. Government bureaucracies have imposed onerous preshipment export licensing requirements and restrictions on foreign investment in export-oriented activities.

CDIE measured export success based on the extent to which the sample countries achieved faster growth in manufactured exports compared with developing countries generally. Using this measure and focusing only on the 1985-1990 period, the sample countries fell into four groups, as shown below.

Table

All the sample countries, except India and Egypt, substantially outperformed the developing country average for the period. This ranking provided a basis for relating export success to the country policy environment. A comparison of alternative measures of economic policy revealed that no single policy dimension was an appropriate predictor of export success; rather, a composite measure provided the best results. The policy dimensions included (1) macroeconomic (monetary, fiscal, and exchange-rate) policies, (2) trade policy (import and export taxes, quotas, prohibitions), and (3) business environment (procedural requirements for investment and exporting). The USAID performance ratings correlated well with the export success of the sample countries during 1985-1990, with Egypt and India falling way behind the others.

Countries with significant export success have insulated the export sector from the effects of remaining antiexport policies. The main approaches included duty drawback, which all of the countries used as a regime of temporary entry for products destined for re-export, and EPZs. All sample countries used or improved on at least one of these approaches to create a favorable policy environment for exports. These schemes were not as effective in Egypt and India, however. In these countries, exporters still faced major problems getting foreign exchange, surmounting procedural obstacles, and acquiring imported inputs.

USAID'S ASSISTANCE APPROACH

Developing countries promote export expansion in a variety of ways, some more successfully than others. One approach, trade and monetary policy, relies on uniform across-the-board incentives and exchange rate management. Another approach is the provision of export services, such as financing, marketing, shipping, freight forwarding, and customs. A third is firm- or industry-specific assistance focusing on technical or marketing issues. The first policy reform offers an incentive for increased exports but does not address production constraints facing exporters in developing countries. In contrast, export services and firm- or industry-specific assistance explicitly target these supply-side constraints, which typically are formidable in developing countries.

During the 1960s, USAID's approach to stimulating export growth focused on policy dialogue and support services to exporters. In Korea, for example, USAID supported policy change that favored exports and helped create government service institutions like the Korea Trade Promotion Agency (KOTRA). USAID efforts in the 1980s in the Caribbean Basin, Asia, and the Near East again focused on policy-based programs aimed at achieving structural reforms to correct antiexport bias. Supply-side constraints, however, made clear that policy reform alone could not rapidly stimulate dynamic outward-oriented growth. USAID addressed these constraints by improving the provision of export services.

The analytical framework shown demonstrates the relationship between subsidized promotion services and export growth. Not all USAID export and investment promotion projects fit each element of the framework. The purpose of most projects, however, was to increase investment in export firms or to increase nontraditional exports, and ultimately to generate foreign exchange and employment.

USAID has subsidized a variety of *export promotion* services, including foreign market information, overseas representation, buyer contacts, trade missions, one-stop shop export windows, training, trade fairs, and technical assistance. Providers range from government trade promotion institutions, such as KOTRA in Korea; to exporter associations, such as the Guild of Non-Traditional Exporters (Gremial) in Guatemala; to privately held export promotion institutions, such as CAAP in Costa Rica; to free-standing programs, such as the Support Program for Non-Traditional Exports in Central America (PROEXAG).

To stimulate export-oriented investment, USAID has supported the provision of *investment promotion* services, including country information (e.g., investment climate), sector-specific information, investment missions, site visit support, joint-venture matchmaking, feasibility studies, and overseas representation. USAID has channeled assistance through both *government* investment authorities and *private* investment promotion institutions. In Thailand and Indonesia, USAID used private sector consulting expertise to build up the service capacity of public sector investment promotion institutions. Elsewhere, USAID has created or assisted private investment promotion institutions, such as CINDE in Costa Rica and IPC in the Dominican Republic.

FINDINGS

Policy and Support Services

The economic policy environment appears to be a fundamental determinant of export success. A review of the export performance and the policy environment of the sample countries revealed that exports performed poorly in poor policy environments. Egypt and India, countries with unquestionably poor policy environments, were notable failures in export growth, notwithstanding a considerable array of special export incentives. The export success of the other countries was closely related to their ranking based on overall economic policy. A broad measure of economic policy, encompassing macroeconomic stability, foreign exchange management, trade policy, and the business environment, provided a good proxy measure for export success. In addition, partial trade reform, such as duty drawback and EPZ-type regimes, has helped create enough of a favorable policy regime for strong export performance. The countries that achieved rapid export growth effectively insulated the export sector from the effects of antiexport policies.

Sound macroeconomic policies and partial trade reform are preconditions for export success, and, in turn, for effective use of subsidized promotion services. For example, in Thailand, which has achieved outstanding export success, the Government pursued macroeconomic stability and a credible foreign exchange rate (policies essential for outward-oriented growth) and subsidized the provision of export promotion services. Incipient Thai exporters considered several support services critical to their export success, including those from the Thai Department of Export Promotion (DEP).

The Rationale for Intervention

Some export and investment service programs have generated a high economic rate of return representing a justifiable use of donor resources. Private firms have often not provided these services because some benefits are public goods, and private firms could not profitably provide them. The principal rationale for intervention in these markets is market failure.

Information gaps can be problematic for firms new to exporting, especially at the earliest stages of an export-oriented trade strategy. New exporters lack knowledge of foreign markets and links to buyers abroad. Survey evidence shows that information is an important factor in export success, particularly in countries that have recently adopted an outward-oriented growth strategy.

Promotion can have a bandwagon effect. Evidence suggests that stimulating initial investment in an industry with strong export potential, such as electronics, leads to substantial follow-on investment and export growth in the same industry.

Market failure should not be assumed. In Korea, USAID assumed market failure where in fact there was none. Foreign buyers, suppliers, and investors were already providing a variety of services to Korean exporters; thus assistance to public promotion agencies, such as KOTRA, added little to Korea's export growth.

Project interventions have helped push the policy process forward. In the Caribbean Basin, USAID-supported institutions worked with governments to develop policy regimes supportive of export-led growth.

Effective Export Promotion

Different firms value different types of services in achieving export success. Incipient exporters value support services that help them form enduring relationships with their business partners, such as buyers and investors.

- *Domestic exporters* valued information (such as foreign market, sector, and country) and contacts that linked them to buyers. Firms also valued services that helped them cope with supply-based constraints, such as technical assistance, sample preparation, and training.
- *Exporters of nontraditional agricultural crops* gave high priority to technology-intensive and highly crop- and product-specific assistance.

- *Joint ventures* valued production-related technical assistance to improve on the capability of their local partners.

*Private sector commitment and involvement and an orientation toward results are critical to effective export promotion programs***.** Gremial in Guatemala, DEP in Thailand, and PROEXAG in Central America were highly rated in contributing to export success. Each program had strong links to private exporters, many of whom participated in the advisory councils and shared the cost of providing services. Their service strategies focused on delivering services valued by firms new to exporting—sector and foreign market information and buyer contacts.

Government trade promotion organizations (TPOs) rarely accelerate export performance. Most exporters gave little or no credit for their export success to government TPOs. Government TPOs have not been effective because they lack decision-making autonomy and specialized expertise. They cannot target those most able to benefit and lack the support of the export community. Only in exceptional cases have government TPOs filled a significant service gap. In Chile and Thailand, they had the authority to weed out those not yet able to export. They had technically qualified staff, and the private sector was committed to the future of these institutions. Both countries also had a highly favorable policy environment and governments fully committed to exports.

The institutional structure of the export promotion strategy needs to fit the type of service provided. Government TPOs and membership organizations, such as exporter associations, have tended to be more effective as providers of standardized services to a wide variety of exporters. In contrast, private TPOs and targeted programs have been more effective in providing firm-specific, customized services.

Effective Investment Promotion

Firms making investment decisions value different services in different country contexts. Investment promotion services have to be responsive to investors' specific needs. USAID-assisted private investment promotion institutions were relatively effective in meeting foreign investors' needs in the Caribbean Basin. Foreign firms considering establishing subsidiaries knew little about the Caribbean region; they thus needed site visit support and information on the country climate, the sector, and the like. In contrast, foreign firms considering joint ventures in Thailand and Indonesia needed information on the country's investment climate and required technical assistance to improve on the capabilities of their local partners.

*Government investment promotion institutions have not been effective in attracting or generating export-oriented investment***.** Firms surveyed placed little or no value on the investment-related services provided by government investment promotion institutions. In Indonesia and Thailand, subsidized investment missions, consulting services, and matchmaking databases generated no new investment. One serious problem has been the inability of these institutions to focus on the information and service needs of foreign investors. Instead, government agencies have been more concerned with screening and regulating investment than with developing strategies to attract and generate foreign investment.

Effective private investment promotion institutions are organized toward achieving results. Such institutions have had significant decision-making control over their service strategies. They are typically structured for overseas marketing, which gives them access to their clients, that is, foreign investors. Unhampered by civil service restrictions, they attract qualified technical staff with a strong private sector orientation.

The Return on USAID's Investment

Export and investment promotion programs can offer attractive rates of return, but in most cases tracking program results is difficult. Rates of return on USAID's investment calculated for four promotional institutions ranged from 12 to 26 percent. Promotional institutions that generated high rates of return had a strong results orientation. In each case, management could provide a firm-by-firm list of investments or exports that could be linked to intervention. Still, this high rate of return is not typical of USAID-assisted efforts. The complications in conducting rate of return analysis suggest that this indicator should not be taken as the sole measure of economic impact.

Services from USAID-assisted institutions have contributed to export success. Firms receiving services from USAID-assisted institutions in the Caribbean Basin had a significantly higher rate of export and employment growth than did randomly selected firms. Exporters achieving rapid export growth in the Caribbean gave assisted institutions substantially more credit for their export success than did firms that were growing more slowly. But exporters in Asia who achieved rapid export growth gave more credit to themselves and hardly any to USAID-assisted institutions.

RECOMMENDATIONS

In developing an economic rationale for a donor intervention, focus first on the policy and regulatory environment (see figure). The questions to address are: Are the basics—macroeconomic stability and a realistic exchange rate—in place? Is the export sector sufficiently insulated from restrictions in the import regime (e.g., through duty-drawback schemes) to support export growth? Is the investment regime open to foreign investment? If the answer to these questions is "no," it may be more appropriate to focus on specific policies or regulatory reform that would permit significant export growth rather than subsidize firm-level services.

Alternatively, if partial trade reforms have created enough of a favorable policy regime for some exporters, then focus on the export support services market. Are buyers, foreign partners, domestic private associations, and firms willing and able to respond to the demand for export support services? If the market is too underdeveloped to respond, focus on identifying the nature of the "gap" and the economic justification for the aid subsidy to fill that gap temporarily. Support services, however, should stimulate, not undermine, the development of competing private service providers. Once a well-functioning market for export support services exists, there is no longer a rationale for intervention.

Implications for USAID programming relate to different country contexts:

1. There is little justification for intervention in outward-oriented economies that have achieved sustained nontraditional export growth. At this stage, subsidized support services are usually redundant and are likely to be competitive with a vibrant private services industry.

2. In countries with macroeconomic instability and an unrealistic exchange rate, the objective should be to bring these under control. The next priority is some form of trade policy reforms that would sufficiently insulate the export sector from restrictions in the import regime to support export growth. Another area for reform is international investment restrictions. If firms cannot link up with the international economy, there will be little to promote.

3. In countries that have achieved macroeconomic stability, a credible foreign exchange regime, partial trade reform, and lifting of investment restrictions, there is a strong rationale for supporting export services. The best time for project intervention may be when countries are undergoing a shift from an import substitution to a more open trade policy regime.

4. In countries where partial trade and investment reforms have only modestly increased potential export expansion, pilot interventions targeting specific sectors may be justified. These interventions must demonstrate specific benefits that would improve firms' access to foreign partners.

Develop service strategies that fill specific gaps facing particular firms.

Domestic manufacturing firms: Consider services, such as foreign market information and buyer contacts, that lead to long-term linkages between developing country firms new to exporting and potential business partners, such as buyers.

Foreign manufacturing firms: Consider services that respond to specific decision-making needs of foreign firms (e.g., wholly owned subsidiaries, joint ventures).

Exporters of nontraditional agricultural crops: Consider services that give firms access to a variety of commercial service providers to obtain technology-intensive and crop-specific support.

Avoid government service providers for either export or investment promotion. Ensure that the institutional structure of the promotional organization fits the type of service to be provided. Do not encourage a government or a membership institution to provide firm-level technical assistance. Encourage private service providers to provide staff incentives to achieve effective service delivery, and allow them flexibility and resources to respond to service "gaps."

Support cost-sharing and other mechanisms to increase the commitment of the private sector and the sustainability of export promotion programs. Consider either assisting more than one private for-profit or not-for-profit provider, or supporting cost-sharing mechanisms that allow firms to select their own service provider. Do not make complete financial self-sufficiency a goal for export promotion programs; instead, create results-focused projects based on a defensible economic rationale.

Focus on bottom-line impact: achievement of nontraditional export growth, employment generation, and improvements in the support services market. Support performance-tracking systems that are integral to the operation of the service provider.

Use simplified approaches to assessing the costs and benefits of most promotion projects and undertake detailed ex post cost-benefit analysis selectively; that is, perform such analysis only on major investments of USAID resources.

This Evaluation Highlights was prepared by Cressida McKean of the Center for Development Information and Evaluation. It summarizes the findings from the forthcoming report Export and Investment Promotion Services: Do They Work? Program and Operations Assessment Report No. 6, which can be ordered from the DISC, 1611 North Kent Street, Suite 200, Arlington, VA 22209-2111, telephone (703) 351-4006; fax (703) 351-4039.